IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:	)	CASE NO. BK02-81781
	)	A03-8011
ROSEN AUTO LEASING, INC.,	)	
	)	CH. 7
Debtor(s).	)	
EUGENE M. ZWEIBACK and EUGENE M. ZWEIBACK IRA, DAIN RAUSCHER, Custodian,	)	
	)	
Plaintiffs,	)	
	)	
vs.	)	
	)	
U.S. BANK, N.A., and THOMAS STALNAKER, Chapter 7 Trustee,	)	
	)	
Defendants.	)	

MEMORANDUM

Trial was held in Omaha, Nebraska on May 17, 2004, before a United States Bankruptcy Judge for the District of Nebraska, regarding Filing 24, Amended Complaint, filed by Eugene Zweiback and the Eugene Zweiback IRA. Ed Hotz appeared for the plaintiffs, Mark S. Carder appeared for U.S. Bank National Association, and Ann Grottveit appeared for the Chapter 7 trustee. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. 28 U.S.C. § 157(b)(2)(B) and (K).

This adversary proceeding is a declaratory action brought by Eugene M. Zweiback, individually, and Eugene M. Zweiback IRA, Dain Rauscher, Custodian ("Zweiback") to determine the validity and extent of a lien in property of the estate. The Chapter 7 trustee in the Rosen Auto Leasing, Inc. ("Rosen Auto") case was a named defendant, and U.S. Bank National Association ("U.S. Bank" or "Bank"), an undersecured creditor in the underlying bankruptcy case, intervened to challenge the lien and the allowance of the claim.

Rosen Auto was in the business of purchasing used automobiles, leasing them, and eventually selling them when they returned from lease. Generally, it financed the purchase of the automobiles by borrowing from a number of banks. One or more lending banks took a blanket lien in the assets of Rosen Auto, including the vehicle inventory and lease packages. Some lenders also took liens on specific vehicles. In the spring of 2002, Rosen Auto filed a Chapter 11 case which was eventually converted to Chapter 7. It appears that the liquidation process has not resulted in creating sufficient cash proceeds to pay a significant distribution to unsecured and undersecured lenders.

In 1998 and 1999, Rosen Auto sold preferred stock to a number of investors. Eugene

Zweiback, a longtime friend of Jerome Rosen, the former longtime president of and, at that time, chairman of the board and major stockholder in Rosen Auto, contributed $700,000 in return for the issuance of preferred shares. Dr. Zweiback became a member of the board of directors and thereafter generally participated in board meetings.

In the summer of 2001, Rosen Auto was suffering from a cash flow shortage. Jerome Rosen discussed with Dr. Zweiback the possibility that Dr. Zweiback would be interested in making a loan to Rosen Auto on a secured basis, to help the company through its cash flow troubles. Dr. Zweiback engaged the services of legal counsel and, after some negotiation, made a commitment to lend the company $300,000 at a particular interest rate, with interest to be paid semiannually and a balloon payment at the end of five years. The loan was to be secured by a second lien on three parcels of real property owned by the company. The real property was encumbered by a first and second lien held by American National Bank of Omaha, Nebraska. Dr. Zweiback agreed to subordinate his secured status to a first lien position by American National Bank, but required the second lien of American National Bank to be removed.

Pursuant to the terms of the loan agreement, the second lien of American National Bank was removed from the real property and the loan closed, with Rosen Auto paying all legal and other costs incurred by Dr. Zweiback.

It appears from the testimony of Jerome Rosen and Richard Otten, the president of Rosen Auto, that the funds received from Dr. Zweiback were used for continuing operations of the business. Part of the negotiated loan commitment required that the real property not only secure the loan of $300,000, but also be treated as security for the $700,000 that Dr. Zweiback had invested in preferred stock two or three years before. The security documents reflect the terms of the agreement.

The cash flow problems of Rosen Auto continued even after the receipt of the $300,000 loan from Dr. Zweiback. Within less than a year after the contribution of the $300,000 by Dr. Zweiback, the debtor went into a Chapter 11 bankruptcy which was eventually converted to Chapter 7.

The Chapter 7 trustee has sold the real estate which was the subject of the lien securing the $300,000 loan and purportedly securing the $700,000 investment in preferred stock. After payment of the first lien held by American National Bank, the trustee holds net proceeds of approximately $470,000.

The trustee questioned the validity and extent of the lien held by Dr. Zweiback and refused to distribute the remaining proceeds to him. This adversary proceeding resulted. The trustee and the bank take the position that the lien held by Dr. Zweiback should be avoided for the benefit of the estate because the $300,000 “loan” should be re-characterized as disguised equity; alternatively, that any claim allowed for Dr. Zweiback should be equitably subordinated to the non-insider claims pursuant to Section 510(c) of the Bankruptcy Code; and alternatively, that the claim should be disallowed as a fraudulent conveyance under Section 548(a)(1)(A) or as a “constructively” fraudulent transfer under 11 U.S.C. § 548(a)(1)(B). Finally, the trustee and the bank take a position that the granting of the lien to secure Dr. Zweiback’s investment in preferred stock in the amount of $700,000 is an avoidable preference because it was a transfer of Rosen Auto’s property on behalf of an antecedent obligation that Dr. Zweiback contends is debt, made at a time when Rosen Auto was insolvent, to an insider of Rosen Auto within one year of the bankruptcy petition, that enabled Dr.

Zweiback to recover more than he would recover in Rosen Auto's bankruptcy if he had not been granted the lien. The statutory support for such position is 11 U.S.C. § 547(b).

FINDINGS OF FACT

1. The investment of $700,000 made by Dr. Zweiback in 1998 or 1999 in preferred stock is not a loan. It is an investment in equity in the company.

2. The language in the deeds of trust purportedly granting a lien in favor of Dr. Zweiback as additional security for his investment in the preferred stock did not create a "lien" as that term is used in the bankruptcy context. The Bankruptcy Code at 11 U.S.C. § 101(37) defines a "lien" as a "charge against or interest in property to secure payment of a debt or performance of an obligation." Dr. Zweiback invested $700,000 in 1998 or 1999 and received, in consideration for such investment, preferred stock in Rosen Auto. Rosen Auto did not incur debt at that time, nor did Dr. Zweiback have the right to expect the performance of any obligation by Rosen Auto.

3. The $300,000 contributed to Rosen Auto by Dr. Zweiback in the summer of 2001 is debt. It is represented by a loan document entitled a "Debenture." It was negotiated by officers of Rosen Auto with counsel for Dr. Zweiback. Its terms are clear. In consideration for the delivery of $300,000, the debtor was to execute a debenture providing for nine percent per year interest, interest payable semi-annually, with a balloon payment at the end of five years. The debenture was to be secured by deeds of trust on three parcels of real estate, granting Dr. Zweiback a second lien on such parcels. The loan closed with the transfer of the funds and the execution of the debenture and deeds of trust and the recording of the appropriate documents.

CONCLUSIONS OF LAW AND DISCUSSION

I. Recharacterization of Debenture as Disguised Equity

Bankruptcy courts apparently have the power to recharacterize a transaction denominated as a loan and determine that the transaction was actually a purchase of equity. Bayer Corp. v. MascoTech, Inc. (In re AutoStyle Plastics, Inc.), 269 F.3d 726, 747-48 (6th Cir. 2001). Although no one factor is controlling and the cases should be determined on a case-by-case basis, AutoStyle does give a list of factors to consider. Those factors include: (1) the names given the instruments evidencing the indebtedness; (2) presence of a fixed maturity date; (3) presence of a fixed interest rate and payments; (4) the source of repayment; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and shareholder; (7) security for advances; (8) the availability of similar loans from outside lenders; (9) the extent to which the "loans" were subordinated to claims of outside creditors; (10) whether the advances were used to acquire capital assets; and (11) the presence of a sinking fund to provide payments. Id. at 749-50 (citing Roth Steel Tube Co. v. Comm'r of Internal Revenue, 800 F.2d 625, 630 (6th Cir. 1986)).

The bank and the trustee acknowledge that the form of the promissory note and deeds of trust reflect that four of the factors here – numbers 1, 2, 3 and 7 – favor debt treatment. The bank and the trustee acknowledge that the testimony at trial was consistent that other stockholders did not make similar contributions in proportion to their stock ownership, and therefore factor number 6 weighs in favor of debt treatment. The testimony is clear that the funds were used for working capital and, therefore, number10 appears to support debt treatment.

The bank and the trustee, however, claim that the substance of five factors support a finding that the contribution was in substance an equity infusion by an existing preferred stockholder. Those five factors include the source of repayment being earnings; the financial data showing that Rosen Auto was undercapitalized when the August 2, 2001, contribution was made; no other non-insider creditors made interest-only real estate loans; and according to the trustee and the bank, the interest-only feature with a five-year term further indicates the equity character of the transaction. Such terms create the risk of non-payment at the end of five years because Rosen Auto had a continuing cash shortfall and was experiencing current substantial monthly losses at the time of the transaction. The loan did not require a sinking fund to be established to ensure repayment and the loan was subordinate in priority to that of American National Bank, and in actuality, subordinate to the claims of non-insider lenders. Dr. Zweiback admitted that he was not paid the interest due in February 2002, and he accepted such treatment even though the non-insider lenders continued to be paid.

Each of the factors cited by the trustee and the bank in support of their assertion that the transaction should be recharacterized as an equity transaction requires a significant stretch of the imagination. The note was to be paid from earnings, as are most notes. However, as security for the repayment of the note, in case earnings were insufficient, Dr. Zweiback insisted upon and received a lien on real estate, second only to American National Bank. At the time of the transaction, Rosen Auto may have been undercapitalized and did have a negative cash position. There is no testimony and there is no reason for this court to believe that Dr. Zweiback, a preferred shareholder but not a majority owner of the common shares of Rosen Auto, would have been willing to invest another $300,000 into the business. He was willing to loan on a secured basis, and did so. As suggested by the debtor in its post-trial brief, there is no reason for a sinking fund when you have real estate security with equity supporting the loan.

There is no legal or equitable basis for recharacterizing this loan as equity.

II. Equitable Subordination

Equitable subordination generally requires (1) some inequitable conduct by the claimant; (2) resulting in injury to other creditors or conferring an unfair advantage on the claimant; and (3) an outcome from the subordination that is not inconsistent with other provisions of the Bankruptcy Code. Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.), 850 F.2d 1275, 1282 (8th Cir. 1988). A claim of an insider is subject to such subordination upon the showing of a breach of fiduciary duty or conduct that is unfair to non-insider creditors. Id. at n.13. Dr. Zweiback is a preferred shareholder and director of the debtor. He is a longtime friend of Jerome Rosen, the chairman of the board of directors and principal common stockholder. His status as a director makes him an "insider" of Rosen Auto pursuant to 11 U.S.C. § 101(31)(B)(i). Neither the bank nor the trustee presented any evidence concerning inequitable conduct by the claimant. Instead, they suggest that because Dr. Zweiback was an insider and because he negotiated for a lien to somehow secure his investment in preferred stock, he breached some duty to the company or his conduct was unfair to non-insider creditors.

This transaction was not unfair to non-insider creditors. The transaction occurred when the company was a going business. It had cash flow difficulties, and Dr. Zweiback contributed an additional $300,000 in an attempt to help the company through its cash crisis. His purported lien to secure the $700,000 preferred stock investment is not enforceable in this bankruptcy case, but

the lien he obtained as security for the $300,000 contribution in August 2001 was fair consideration for the contribution.

The bank and the trustee suggest that the lien was unfair even for the $300,000 portion attributable to the new contribution because it was insufficient to correct the negative cash position of Rosen Auto or reverse the continuing losses leading inevitably to bankruptcy. In other words, the bank and the trustee are suggesting that because Dr. Zweiback made a bad business decision and loaned $300,000, he should be found to have acted to harm non-insider creditors. In hindsight, it appears that the loan of $300,000 did not ultimately benefit non-insider creditors, but there is no evidence that the loan was made in the hope of keeping Rosen Auto in existence, intentionally increasing the risk of increased ultimate losses to the non-insider creditors.

With regard to the attempt by Dr. Zweiback to obtain security to protect him from the loss of his $700,000 preferred stock investment, it is clear that the $700,000 is equity and not debt. The director and shareholder consent resolutions to the granting of the lien in consideration of the loan of $300,000 do not authorize the granting of a lien to secure the preferred stock investment. The claim regarding the $700,000 investment is subordinated to non-insider claims and the lien purportedly securing such claims is not even a "lien" as that term is used in the Bankruptcy Code.

The claim based upon the $300,000 loan made by Dr. Zweiback to Rosen Auto in 2001 is not subordinated to the interest of any other creditors.

III. Disallowance of Claim Due to Fraudulent Transfer

There is no basis for disallowing the claim for the $300,000 loan as a fraudulent transfer. There is no evidence that the lien on the real estate was granted with the intent to hinder, delay or defraud creditors. The transfer was made in consideration for a loan of $300,000 with a term of five years secured by real estate. The loan was approved by the directors. The funds were used for the benefit of the debtor in its operations.

IV. Disallowance of Claim for Constructively Fraudulent Transfer

A transfer may be deemed "constructively" fraudulent if Rosen Auto did not receive reasonably equivalent value for the deeds of trust and was insolvent, engaged in business for which it had unreasonably small capital, or incurred debts beyond its ability to pay as they matured.

As has been discussed above, Rosen Auto transferred liens represented by deeds of trust in consideration for $300,000. That is reasonably equivalent value. Dr. Zweiback has a lien only to the extent of the $300,000 principal plus accrued interest at the default rate, plus attorney fees, up to the total amount of the net proceeds held by the trustee from the sale of the real estate. The loan was in default on the date the bankruptcy petition was filed, and, therefore, the default rate of interest was in place on the bankruptcy filing date. To the extent there are sufficient funds available to cover the default interest rate, Dr. Zweiback has the right to such amount.

CONCLUSION

Judgment will be entered in favor of Dr. Zweiback and against the bank and the trustee with regard to the $300,000 loan. The claim is allowed in the amount of $300,000 plus accrued and

accruing interest at the default rate, plus reasonable attorney fees, to the extent the trustee has sufficient funds from the sale of the real estate. Although the deed of trust documents purport to grant a lien in the real estate to secure the $700,000 preferred stock investment, such lien is unenforceable in bankruptcy because it does not represent security for a debt. If a claim has been filed related to the $700,000 investment, that claim is disallowed and/or subordinated to the interest of the non-insider creditors.

Separate judgment to be filed.

DATED this 17th day of September 2004.

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
*Ed Hotz & Anne M. Breitkreutz
Mark S. Carder
Ann Grottveit
Thomas M. Stalnaker
U.S. Trustee

Movant (*) is responsible for giving notice of this order to all other parties not listed above if required by rule or statute.

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IT IS ORDERED: Judgment is hereby entered in favor of Dr. Zweiback and against U.S. Bank, N.A., and the Chapter 7 trustee with regard to the $300,000 loan. The claim is allowed in the amount of $300,000 plus accrued and accruing interest at the default rate, plus reasonable attorney fees, to the extent the trustee has sufficient funds from the sale of the real estate.

IT IS FURTHER ORDERED: Judgment is entered in favor of the defendants with regard to the $700,000 investment. If a claim has been filed related to that investment, that claim is disallowed and/or subordinated to the interest of the non-insider creditors.

See Memorandum entered contemporaneously herewith.

DATED this 17th day of September 2004.

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

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